BRYAN CAVE
A Broader Perspective
Bulletin

Private Client Group

To: Our Clients and Friends September 2013

Trustees' Quick Guide to FATCA

What Is It?

A US tax information-gathering regime applicable to foreign financial institutions ("FFIs") and nonfinancial foreign entities ("NFFEs") enforced by a 30% penalty tax regime applied to US source interest, dividends and other similar income. The 30% penalty tax will eventually apply as well to gross proceeds of sale of US bonds and US shares. In most foreign trust and private investment company circumstances the tax will not be recoverable once withheld.

What Private Trusts are Affected?

All foreign trusts that invest in the United States either directly or through one or more private companies or collective investment vehicles will be affected.

Is the Trust or its Holding Company an FFI?

A foreign private trust or company that receives more than 50% of its gross income from investing in financial assets will be an FFI if the entity is "managed by" another entity that is a financial institution. A trust or holding company is treated as managed by a financial institution "if the managing entity performs, either directly or through a third party service provider" any of a number of functions including investment management or asset administration. A foreign private trust or company that is not an FFI or an "excepted NFFE" will be either a "passive" or an "active" NFFE.

What is Disclosed Under FATCA?

The FATCA regime as implemented in the final Treasury regulations requires that information relating to an FFI's "US accounts" be disclosed annually to the IRS. This includes the name, address and US taxpayer identification number of each US taxpayer who is an account "holder" or who is a "substantial US owner" of an account holder that is a foreign entity. Distributees of trusts who refuse to provide all relevant information will not have their personal details disclosed, however, the FFI through which the trust invests will first impose the 30% penalty tax withholding regime and eventually will be required to close the trust's "recalcitrant" account.

Will an IGA Help?

The US Treasury is now proactively pursuing implementation of bi-lateral inter-governmental agreements known as "IGAs" with a large number of countries. This represents an apparent shift of policy; when FATCA was enacted it was understood that IGAs were to be pursued only with

countries with which the United States already has a comprehensive income tax treaty. The United Kingdom was the first country to sign an IGA, and in August it issued implementing regulations and guidance notes. The Cayman Islands has recently initialled an IGA; it is now anticipated that most offshore centres will enter into IGAs before the FATCA regime takes effect.

An FFI subject to an IGA has the benefits that generally it will not be required to implement withholding itself and it will be able to comply with the FATCA information reporting requirements without violating local law data protection or privacy laws. Specifically, under a "Model 1" IGA, compliance is achieved by reporting details of holders of US accounts to the tax authority of the local jurisdiction (who in turn transmits the information to the US Treasury) rather than reporting directly to the IRS (but each "reporting" FFI must register on an IRS website). However, withholding by the last US payor in the chain of payments will apply if the FFI does not report (if required) to the local jurisdiction or the FATCA partner does not comply with its obligations under the IGA. Under a "Model 2" IGA, reporting of information on holders of US accounts is directly to the IRS.

In addition, the current Model IGA Annex II (and the UK HMRC guidance to the UK IGA) adds a new concept of "Trustee-Documented Trust" that in some cases allows the trustee, rather than the trust as an entity, to provide required information to the local government.

Potential drawbacks of an IGA include:

- Under the current Model IGA (and the UK HMRC guidance) there is no distinction between an account held by a grantor trust and an account held by a nongrantor trust. The HMRC guidance explicitly states that an account held by a trust is treated as owned by the trust "rather than any owner". Thus it appears that the grantor trust itself must comply with the IGA if it meets the definition of financial institution. Under the final Treasury regulations the holder of an account held in the name of a grantor trust with only one grantor is defined as the grantor rather than the trust. Despite this it is not yet clear under separate rules in the Treasury regulations whether a withholding agent may treat the payee of that account as the individual grantor rather than the trust as an entity, nor whether the trust itself is an entity that must comply with FATCA. The current draft Forms W-8BEN-E and W-8IMY shed little light on this issue but presumably the instructions when issued will resolve the uncertainty.
- Under the current Model IGA (and UK IGA) the definition of an "equity" interest in a trust includes a much wider group of individuals than the definition under the final Treasury regulations, which is limited to individuals who actually receive or are entitled to receive trust distributions in a particular year. The IGA definition includes all individuals who may receive a "discretionary" distribution (regardless of whether the individual has in fact received a distribution), an individual entitled to a mandatory distribution, the settlor and "any other natural person exercising ultimate effective control" over the trust. However the UK HMRC guidance on reporting of US accounts draws on the definition in the Treasury regulations, stating that a US taxpayer discretionary beneficiary must be reported only if he or she receives a distribution during the calendar year. Presumably other governments will follow HMRC's lead in implementing their own IGAs to include the more favourable final Treasury regulations rule.
- Under the Treasury regulations the reporting of information on the owner of a passive NFFE is limited to "substantial US owners", defined as a 10% or greater (direct or indirect) owner. Under the current Model IGA, information must be provided by an IGA entity on any US taxpayer who

is a "Controlling Person" with respect to the passive NFFE. For a trust, this includes not only beneficiaries, but also the trustees, the protector and "any other person exercising ultimate effective control" over the trust. There is no minimum percentage test applied for this purpose.

- Determining whether a particular entity is subject to an IGA will not always be straightforward. The Model IGAs allow the jurisdiction when negotiating with the Treasury to choose either residence or law of organization as the connection that triggers application of the IGA to a particular entity, while the "Trustee-Documented Trust" category in Annex II to the Model IGAs applies only to trusts “established under the law of” the IGA jurisdiction (apparently even if the IGA otherwise uses residence as the basis for IGA jurisdiction, so a trust resident in such an IGA jurisdiction but not governed by the laws of that jurisdiction could not choose Trustee-Documented status). The UK IGA uses the concept of "residence" to determine whether an entity is within its scope and the HMRC guidelines confirm that a trust's residence is determined for IGA purposes in the same way as for general UK tax purposes. The UK IGA Annex II adopted in June 2013 requires a trust to be “established in the United Kingdom” (rather than “under the laws of” the jurisdiction as stated in the Model Annexes) to be eligible for “Trustee-Documented Trust” status, however the HMRC guidelines appear to ignore this aspect of the UK IGA and refer only to a trust being resident in the United Kingdom.

What are the Compliance Deadlines?

- 25th April 2014 - last day to register as a "Participating Foreign Financial Institutions" (PFFI) or a "Registered Deemed-Compliant FFI" for inclusion on the "IRS FFI List" in June 2014 (ensures no permanent penalty tax withholding).
- 1st July 2014 - basic withholding on direct payments of US source income begins subject to exceptions for "pre-existing obligations" and "pre-existing accounts".
- 1st January 2017 - withholding on direct payments of gross proceeds of sale of US bonds and shares begins.
- 1st January 2017 or later - withholding by PFFIs on "pass-thru" payments begins.

What Should Trustees Do Next?

Trustees and directors of private investment companies are likely to begin receiving demands for completion of new Form W-8BEN-E (or Form W-8IMY for a grantor or simple trust) as soon as it is published in final form later this calendar year and in any event prior to 1st July 2014. To complete the form a trustee must first determine whether the trust is a "grantor" or "nongrantor" trust and, if nongrantor, whether it is a "simple" or "complex" trust. Next the trustees/directors must determine whether the trust/company is an FFI or an NFFE. If it is an NFFE they must determine whether it is an "excepted" NFFE, or if not then whether it is an "active" or "passive" NFFE.

If an FFI, the trustees/directors must then decide whether the trust/company is an IGA entity. If not, they must decide whether the entity will be a PFFI (either directly or "sponsored"), an "owner-documented" FFI or a non-compliant FFI for the time being and the consequences of choosing each possible status. As part of that process the trustees/directors must ascertain what members of the beneficial class of the trust will constitute "account holders" and whether each account holder will be willing to provide the trustee with a Form W-8BEN (if a non-US taxpayer) or a Form W-9 (if a US

taxpayer), waive any applicable privacy laws, etc., all bearing in mind various exemptions and extensions of compliance dates applicable to pre-existing accounts. If PFFI status is chosen, the trustees/directors must disclose to the IRS annually only US taxpayer beneficiaries who have received distributions in the reporting year. If owner-documented FFI status is chosen the trustees/directors must provide to the withholding agent a completed Form W-8BEN or W-9, as applicable, for all individuals (US or foreign) who have received distributions in the reporting year and thus are treated as owners, or alternatively a Form W-9 for each US taxpayer distribute together with an "auditor's letter" confirming that the entity qualifies for owner-documented FFI status.

If the trust/company is an FFI that is subject to an IGA, then the trustees/directors must decide whether it will be a Reporting IGA FFI or a Nonreporting IGA FFI. To qualify as Nonreporting, the trust/company must meet the Treasury regulation requirements for an "owner-documented" FFI, one of the other types of deemed-compliant FFIs or one of the Model IGA Appendix II definitions of exempt entities, e.g. a "Trustee-Documented Trust". If the entity becomes a Reporting IGA FFI and if implementing regulations or guidance to the IGA governing it follows the UK approach, the entity will be treated as having a reportable account only if a US taxpayer is entitled to mandatory distributions, receives a discretionary distribution in the reporting year or is otherwise treated as a "Beneficial Owner" of the trust, which will likely include any individual exercising ultimate effective control over the trust. However if implementing regulations or guidance to the IGA do not follow the UK approach but instead mirror the provisions of the IGA itself, the entity will also be treated as having a reportable account for each US taxpayer who may receive a discretionary distribution from the trust even if no distribution is made to that beneficiary. In such circumstances the trustees may decide that achieving owner-documented FFI status, which does not require disclosure of any individual who did not receive a distribution, is preferable to Reporting IGA FFI status.

If the trust/company is a passive NFFE that holds an account with a Reporting IGA FFI, it must identify whether the settlor, anyone who can receive a distribution from the trust, any of the trustees, the protector and/or any other natural person exercising ultimate effective control over the trust is a US taxpayer. If so the account is a reportable account and the Reporting IGA FFI must disclose details of that US taxpayer to the tax authority of the local jurisdiction (which will in turn disclose those details to the IRS).

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